

§ 105(a)  
§ 553(a)  
setoff  
allocation  
tax refund

In re Moore

Case # 695-61480-aer13

9/3/96

AER

published

Debtors' Chapter 13 plan which provided for full payment of all priority unsecured debt and no payment for general unsecured debt was confirmed. Post confirmation the IRS filed a motion for relief to obtain permission to setoff a prepetition tax refund against its claim, allocating the refund first to the general unsecured portion and then to the priority portion. Debtors opposed, arguing the refund should be paid over to the Chapter 13 Trustee for distribution as per the plan, or in the alternative, that the refund should be allocated first to priority debt. The parties agreed that application of the refund to the priority portion of the IRS claim was necessary to the feasibility of the plan.

Held: The IRS' right to setoff survived confirmation. As to allocation, the court adopted the Supreme Court's reasoning in U.S. v. Energy Resources Co., Inc., 495 U.S. 545, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990) and held that when necessary for the feasibility of Debtors' plan, the court may exercise its powers under § 105(a) and order the IRS to allocate the refund first to the priority portion of its claim.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In Re: ) Bankruptcy Case No.  
) 695-61480-aer13  
CHRISTOPHER L. MOORE and )  
RAMIE A. MOORE, ) MEMORANDUM OPINION  
) )  
Debtors. )

This matter comes before the court upon the motion of the United States of America, by and through its agency, the Internal Revenue Service (IRS) for relief from stay to apply a tax refund to pre-petition tax liabilities.

## BACKGROUND

The debtors filed their petition for relief pursuant to Chapter 13 of the Bankruptcy Code, herein, on April 24, 1995. On May 4, 1995, they filed their Chapter 13 plan dated May 3, 1995. The plan provides in pertinent part that the debtors shall pay the sum of \$200 each month to the Chapter 13 trustee. All debts entitled to priority pursuant to 11 U.S.C. § 507 are to be paid in full, general unsecured claims shall receive no payment. The

1 debtors' Chapter 13 plan was confirmed by an order entered, herein,  
2 on November 8, 1995.

3 On March 27, 1996, the IRS filed its Motion for Relief from  
4 Stay to Apply Over Payment to Pre-petition Tax Liabilities. The  
5 motion indicates that the IRS has a pre-petition claim in the  
6 aggregate sum of \$13,340.38. The IRS contends that \$11,079.49 of  
7 this amount is entitled to priority. The IRS concedes that the  
8 remaining sum of \$2,260.89 is a general unsecured claim. The IRS  
9 concedes that a debt is due to the debtors in the form of a tax  
10 refund for the year ended December 31, 1994 in the sum of \$5,582.  
11 The IRS seeks relief from stay to set off the tax refund against  
12 the debt owed by the debtors to the IRS. The IRS proposes to apply  
13 the tax refund first to payment in full of its general unsecured  
14 claim in the amount of \$2,260.89.

15 On April 4, 1996 the debtors filed their response to the IRS  
16 Motion for Relief, contending that the refund should be paid over  
17 to the Chapter 13 trustee for distribution in accordance with the  
18 confirmed plan in this case and that the IRS should only be paid in  
19 accordance with the plan on its priority claim.

20 On May 8, 1996 a hearing was held on the Motion for Relief.  
21 At the hearing, the trustee represented that the confirmed plan  
22 would no longer be feasible if the proposed allocation by the IRS  
23 were to be allowed. In other words, a full application of the  
24 refund to the priority claim of the IRS would be needed in order  
25 for the plan, as confirmed, to be properly funded. The trustee  
26 also represented that the debtors were not current in their plan

1 payments at that time and that there was a trustee's Motion to  
2 Dismiss pending. The IRS maintained that it would not be  
3 adequately protected if it were forced to turn over the refund to  
4 the trustee in light of the debtors' right to dismiss the pending  
5 Chapter 13 proceeding.

6 This court's findings and conclusions resulting from the May  
7 8, 1996 hearing are set forth in an order entered, herein, on July  
8 11, 1996. In pertinent part, this court found and concluded that  
9 the IRS's right to set off under § 553 of the Bankruptcy Code  
10 survived confirmation of the debtors' Chapter 13 plan in this case,  
11 that partial relief from the stay would be granted to enable the  
12 IRS to retain the 1994 tax refund, but that any final determination  
13 regarding the allocation of the refund would be deferred. This  
14 court further noted that any further action in this case would  
15 await the outcome of the trustee's motion to dismiss this case.  
16 Finally, if the debtors were to bring their Chapter 13 plan  
17 payments current and the trustee's motion to dismiss were to be  
18 withdrawn, a further hearing would be scheduled to determine the  
19 allocation issue.

20 The trustee has filed a withdrawal of his motion to dismiss  
21 this case. The parties have indicated to this court that they are  
22 satisfied with the record presently before this court concerning  
23 the allocation issue, that they do not wish to be heard further and  
24 that the matter is now ripe for decision. None of the factual  
25 matters recited herein are disputed.

26 //



1 (Bankr. D. Id. 1995). It is clear that under non-bankruptcy law,  
2 the IRS may credit the 1994 refund to any tax liability owed by the  
3 debtors. In short, the allocation proposed by the IRS would be  
4 allowed.

5 The ruling of the Ninth Circuit in In re Technical Knockout  
6 Graphics, Inc., 833 F.2d 797 (9th Cir. 1987) describes the general  
7 rule on the allocation issue in bankruptcy. There, a Chapter 11  
8 debtor sought to allocate payments it made to the IRS to that  
9 portion of the debt considered to be "trust fund" taxes resulting  
10 from an employee withholding tax liability to protect the debtor's  
11 principals from personal liability. The IRS maintained it could  
12 allocate the payments to the non-trust fund taxes in order to  
13 maximize the government's recovery. The court noted that when a  
14 tax payer makes voluntary payments to the IRS the taxpayer has the  
15 right to designate to which liability the payment will be applied.  
16 It also observed that when the payments are involuntary, the IRS  
17 may apply the payments to whatever liability it chooses. The court  
18 concluded that payments made by a Chapter 11 debtor-in-possession  
19 are involuntary; thus, the IRS could control the allocation of  
20 payments.

21 The court reached a similar result in In re Junes, 76 B.R.  
22 795 (Bankr. D. Or. 1987), a Chapter 13 case. There, the IRS was an  
23 under secured creditor holding both priority and non-priority tax  
24 claims. The IRS wished to require the debtor to treat the non-  
25 priority tax debt as secured to maximize its recovery. The debtor  
26 proposed to allocate the value of the collateral first, to the

1 priority tax claims. Judge Hess concluded that "[P]ayments  
2 pursuant to a Chapter 13 plan which are required by the provisions  
3 of Chapter 13 are involuntary payments." 76 B.R. at 796.  
4 Accordingly, he concluded that the IRS could require that the value  
5 of the collateral be allocated first, to the non-priority claim.

6 The court dealt with the issue of a tax refund owing to the  
7 debtors as a result of a pre-petition overpayment in In re Lawson,  
8 supra. In holding that the IRS could set off the refund first,  
9 against its non-priority claim, the court held:

10 The priorities given by Section 507 are expressions  
11 of Congressional policy that certain claims against a  
12 debtor should be given priority in payment above  
13 others. It would completely defeat this statutory  
14 scheme if a debtor were allowed to set off its claims  
against the creditor, first against the creditors'  
priority claims and secondly against the creditors'  
non-priority claims. 187 B.R. at 8 & 9.

15 The court did note, however, that "The trustee does not contend the  
16 debtors need the tax refund in order to enable them to finance  
17 their Chapter 13 plan." 187 B.R. at 8. In accord, see In re  
18 Carter, 125 B.R. 832 (Bankr. D. Kan. 1991).

19 **Exception:**

20 The courts have observed that the application of § 553 set  
21 off is permissive rather than mandatory. See In re Medina, 177  
22 B.R. 335 (Bankr. D. Or. 1994); In re Lawson, 187 B.R. 6 (Bankr. D.  
23 Id. 1995); and In re Cascade Roads, Inc., 34 F.3d 756 (9th Cir.  
24 1994).

25 The Supreme Court in United States v. Energy Resources Co.,  
26 Inc., 495 U.S. 545, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990) created

1 an exception to the general rule described above. The situation  
2 was similar to that presented to the Ninth Circuit in Technical  
3 Knockout Graphics, Inc., in that trustees in Chapter 11 proceedings  
4 sought to allocate payments to the IRS to the trust fund portion of  
5 taxes owed. The Supreme Court noted that § 105(a) provides in  
6 part: "The court may issue any order, process, or judgment that is  
7 necessary or appropriate to carry out the provisions of this  
8 title." Accordingly, the Supreme Court concluded that the  
9 bankruptcy court could order the IRS to apply payments first, to  
10 offset trust fund obligations if the bankruptcy court concludes  
11 that this action would be necessary for the success of the  
12 reorganization in Chapter 11. See also In re Deer Park, Inc., 10  
13 F.3d 1478 (9th Cir. 1993).

14 //

15 //

16 //

17 //

18 //

19 //

20 //

21 //

22 //

23 //

24 //

1           Given the similarity between § 1141 and § 1327<sup>1</sup>, it appears  
2 clear to this court that the holding of Energy Resources should be  
3 applied in Chapter 13 cases to the same extent it is applicable in  
4 Chapter 11 cases. Here, unlike the situation in Lawson, the  
5 parties agree that the tax refund is necessary in order to enable  
6

---

7           <sup>1</sup>§ 1141. Effect of confirmation (provides in part):

8           (a) Except as provided in subsections (d)(2) and  
9 (d)(3) of this section, the provisions of a confirmed plan  
10 bind the debtor, any entity issuing securities under the  
11 plan, any entity acquiring property under the plan, and  
12 any creditor, equity security holder, or general partner  
in the debtor, whether or not the claim or interest of  
such creditor, equity security holder, or general partner  
is impaired under the plan and whether or not such  
creditor, equity security holder, or general partner has  
accepted the plan.

13           (b) Except as otherwise provided in the plan or the  
14 order confirming the plan, the confirmation of a plan  
vests all of the property of the estate in the debtor.

15           (c) Except as provided in subsections (d)(2) and  
16 (d)(3) of this section and except as otherwise provided in  
17 the plan or in the order confirming the plan, after  
18 confirmation of a plan, the property dealt with by the  
plan is free and clear of all claims and interests of  
creditors, equity security holders, and of general  
partners in the debtor.

19           § 1327. Effect of confirmation

20           (a) The provisions of a confirmed plan bind the  
21 debtor and each creditor, whether or not the claim of such  
creditor is provided for by the plan, and whether or not  
such creditor has objected to, has accepted, or has  
rejected the plan.

22           (b) Except as otherwise provided in the plan or the  
23 order confirming the plan, the confirmation of a plan  
vests all of the property of the estate in the debtor.

24           (c) Except as otherwise provided in the plan or in  
25 the order confirming the plan, the property vesting in the  
26 debtor under subsection (b) of this section is free and  
clear of any claim or interest of any creditor provided  
for by the plan.

1 the debtors to perform their confirmed Chapter 13 plan. The plan  
2 will no longer be feasible if the allocation proposed by the IRS is  
3 allowed. Accordingly, following the holding of the Supreme Court  
4 in Energy Resources, this court, exercising the powers conferred  
5 under § 105(a), may order the IRS to allocate the 1994 income tax  
6 refund first, to that portion of its claim entitled to priority,  
7 prior to any allocation to that portion of the claim which is a  
8 general unsecured claim. An order consistent herewith shall be  
9 entered.

10  
11 ALBERT E. RADCLIFFE  
12 Bankruptcy Judge  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26